



FEDERAL ELECTION COMMISSION  
Washington, DC 20463

**MEMORANDUM**

**TO:** Rosemary Smith  
Associate General Counsel

**FROM:** Office of the Commission Secretary *MWD*

**DATE:** May 13, 2004

**SUBJECT:** *Ex Parte* Communication – Political Committee Status  
Rulemaking

Attached is an e-mail received by Commissioner Thomas regarding the above-captioned matter.

**cc:** Commissioners  
Staff Director  
General Counsel  
Press Office  
Public Disclosure

**Attachment**




FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20463

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SECRETARIAT

2004 MAY 13 A 8:07

MEMORANDUM

TO: MARY DOVE  
COMMISSION SECRETARY

FROM: SCOTT E. THOMAS   
COMMISSIONER

SUBJECT: EX PARTE COMMUNICATION  
RE. POLITICAL COMMITTEE STATUS RULEMAKING

DATE: MAY 12, 2004

The attached e-mail, which includes an article from the *Washington Monthly*, was sent to me by Betty King.



b-king@

05/12/2004 01:22 PM

To sthomas@fec.gov

cc

bcc

Subject

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2004 MAY 13 A 8:07

So, what are y'all doing about 501(c)6s? Should I file a complaint?

--

Betty King  
4233 Royal Palm Avenue  
Miami Beach, FL 33140-3016

----- Forwarded Message: -----  
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Date: Wed, 12 May 2004 13:22:54 +0000

While everyone has been railing against "527s," the new "soft money" organizations, the press has given the Republicans a pass on their much more secretive 501c-6's -- at least until now. Read all about it and spread the word:

<http://www.washingtonmonthly.com/features/2004/0405.confessore.html>

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May 2004

# Bush's Secret Stash

Why the GOP war chest is even bigger than you think.

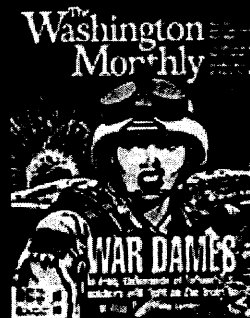
By Nicholas Confessore

Like the natural world, campaign finance is governed by inescapable laws of physics. One is that what goes up usually keeps going up: During every presidential election, the two parties manage to raise more money than they did the last time around. Another is that any given action rarely produces an equal and opposite reaction. Every four years, the GOP outraises and outspends the Democratic Party, usually by tens of millions of dollars.

Until recently, the Democrats could even the scales somewhat by raising "soft" money, the unlimited contributions from rich individuals, corporations, and labor unions that flowed to both parties in roughly equal amounts during the 1990s. But two years ago, the McCain-Feingold Act prohibited parties from raising soft money, a goal long sought by liberal newspaper editorialists and good-government activists. Ever since, the Democratic Party's fundraising has lagged even farther behind the GOP's than usual.

But last summer, a coterie of labor campaign operatives, liberal advocacy-group leaders, and old Clinton hands began exploiting one of McCain-Feingold's loopholes. They organized several groups under Section 527 of the tax code to raise and spend the soft money which the Democratic Party no longer could. Scores of wealthy liberals, among them George Soros, have together given tens of millions of dollars to these "527s," which have generic names like Americans Coming Together and Voices for Working Families. And in March and April, these groups spent a chunk of the money on issue ads attacking Bush, just as Bush was spending

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— James Carville

\$50 million from his campaign war chest to attack Kerry. Though Kerry has raised \$85 million worth of the \$2,000 and under "hard money" donations permitted under McCain-Feingold--a Herculean amount for a Democrat--Bush has raised more than twice that. Without help from the 527s, the Kerry campaign would probably be in big trouble.

The GOP, of course, is well aware of this. Which is why its lawyers have filed legal challenges with the Federal Election Commission to get the 527s shut down, charging that this "Democratic shadow party" represents a "conspiracy" to "illegally" pump soft money into the presidential race. Such campaign finance groups as Democracy 21, the Campaign Legal Center, and the Alliance for Better Campaigns--which once butted heads with Bush over his opposition to McCain-Feingold--have joined the battle against this new Democratic weapon, as have anti-soft money editorial boards at newspapers across the country. In an editorial titled "Soft Money Slinks Back," *The New York Times* inveighed against "political insiders" who were "carving a giant loophole" in election law, while the *Los Angeles Times* called upon the FEC to "issue tough new rules" against the 527s. The Boston Globe was even more acerbic, raging in April that the commission "has all but declared itself impotent to act during this election cycle."

Thus chastened, the FEC last month held two days of hearings on the issue. But a curious thing happened. Instead of coming in for the kill, the GOP's lawyers who were invited to testify refused to appear. Why did they pass up an opportunity to potentially cripple the Kerry campaign, an opportunity for which they had implored the commission for months? Because the FEC had decided that, as long as it was trying to figure out what kind of political activities were legal for 527s, it should also take a look at another category of organizations, known as "501(c)s." Many well-known groups--from AARP to the Nature Conservancy--are set up under Section 501(c) of the tax code, and are also allowed to raise and spend donations for political purposes, including running television "issue ads" that mention candidates. And such 501(c)s as the National Rifle Association and the National Right to Life Committee are vital allies of the GOP; they raise money mostly from their members and use it to buy ads or direct mail supporting the position of one candidate (usually the Republican) or attacking the position of another (usually the Democrat) on issues important to the group. The GOP lawyers had an obvious interest in not wanting the FEC to do anything that might cripple these groups' ability to help the party.

But they were also eager to protect a whole other category of 501(c)s--one that has garnered little attention from campaign finance reform groups or reporters covering the 2004 election. Like the Democratic 527s, these groups have innocuous-sounding names: Americans for Job Security, for example, and Progress for America. Like the 527s, these groups are staffed by veteran party operatives and, in practice, are wholly or primarily devoted to getting their side's candidates elected. And like the 527s, they may raise and spend unlimited amounts of soft money on radio and television ads, direct mail, and voter contact efforts.

There are, however, a few key differences that make 501(c)s a far more insidious vehicle for soft money. The law does not require that they disclose how much they spend until well after Election Day. Worse, they don't have to disclose who their

donors are at all. Even foreign governments can in theory give money, with no questions asked. No one knows how much the Republican shadow party has raised or will spend this year. But the tens of millions they spent in 2002 were instrumental in putting the Senate back in GOP hands--and there's every possibility they could help push Bush and the Republicans over the line come November.

### **They've got issues**

One of the peculiarities of Washington's influence industry is that large parts of it aren't actually in Washington. If you wanted to learn what issues are important to, say, the American Academy of Physician Assistants or the National Rural Letter Carriers Association, you'd have to journey beyond the district line, and in particular to Alexandria, Va., a small suburb located a few miles down the Potomac. Not too long ago, Alexandria was a fading industrial center, its economy kept afloat by tourists and antique-hunters treading the quaint brick sidewalks of colonial-era Old Town. But beginning in the early 1990s, hundreds of trade associations--drawn by the cheap office space, city-subsidized financing, and easy access to Capitol Hill--began setting up shop here. So many trade associations have flocked here during the past decade, in fact, that they've become the city's second biggest industry, producing almost as many jobs as the local tech businesses.

One of the recent arrivals is Americans for Job Security, located in a tidy brick building on the northern border of Alexandria's new white-collar sprawl. "It's so much cheaper out here than being downtown," says AJS's president, Michael Dubke, as he greets me at the front door and leads me into a nondescript conference room. Like many of its neighbors, AJS is organized as a 501(c)(6), which is to say a not-for-profit "business league" or trade organization. But as trade organizations go, it is rather unusual. Not only is the group's membership--several hundred individuals, corporations, and other trade organizations--secret, but by all appearances, the members don't share a particular line of business. Despite a budget of millions of dollars a year, AJS doesn't have the kind of public relations or policy staff that, say, the Chamber of Commerce does. In fact, Dubke, a cheerful, clean-cut 33-year-old with the rangy build of an ex-jock, is AJS's sole employee. The group has no Web site, puts out no policy briefs or press releases, and does no lobbying on the Hill.

About the only thing that AJS does is buy television, radio, and newspaper advertisements--lots of them. This is a source of pride for Dubke. "Ninety-five percent of the money that we take in membership [dues] is spent on our grassroots lobbying," he tells me, like a discount carpet salesman bragging about his low overhead. "We spend our money on product." During the hotly contested 2000 race, widely regarded as a watershed election for issue advertising, AJS spent about \$9 million on political ads. A chunk of the money went towards attacking Democratic presidential candidate Al Gore for his prescription-drug plan, with ads airing in such key media markets as Spokane, Wash., and Tampa, Fla. (All told, according to a study by the Brennan Center, AJS was the most active outside group supporting Bush in 2000.) But AJS didn't stick to the presidential race. It also spent millions of dollars on behalf of Republican candidates in closely-fought Senate races in Michigan, Nebraska, and Washington. During the midterm elections two years later, with Democratic control of the Senate at stake, AJS dumped another \$7

million into advertising, again mostly in key races, notably Minnesota's.

Traditional 501(c) groups run ads on a narrow set of issues important to their members. This year, for instance, the NRA might run ads attacking candidates who support extending the ban on assault weapons, while the Sierra Club might air spots against candidates who support drilling in the Arctic National Wildlife Refuge. AJS, by contrast, is more catholic in its interests. During the last two election cycles, the group's campaign ads have addressed taxes, education, tort reform, prescription drugs, immigration, dam removal in the Pacific Northwest, even federal regulation of drinking water--"basically anything we label a 'pro-paycheck' message," Dubke remarks.

Much like a political party, AJS only seems to lurch into action at election time, even if one of its many core issues is being debated in Congress at some other time. Traditional Washington trade associations expend most of their resources trying to affect the legislative process, but Dubke sees this as a waste of time. "Our main purpose is to get these public policy issues out into the debate," he told me. "I have yet to have somebody tell me when is a better time to talk about public policy issues" than during campaign season.

Aside from timing, about the only thing AJS's ads have in common is that nearly all of them attack Democrats, usually those in tight races. And although groups running "issue ads" are not supposed to coordinate with candidates, in at least some cases AJS appeared to do just that. During 2000, for example, AJS launched a massive ad campaign in support of embattled incumbent Sen. Spencer Abraham (R-Mich.). As *Newsweek* reported that year, funding for the ads came from the tech industry, which cut checks to AJS at the request of then-Senate Majority Leader, Trent Lott (R-Miss.), Abraham's mentor. In 2002, the group ran ads in Alaska, where incumbent Republican Sen. Frank Murkowski was in a tight race with the state's Democratic lieutenant governor. According to published reports at the time, AJS's ads followed a conference with Murkowski's political consultant and used the same themes that Murkowski's own campaign was employing.

### **The other shadow party**

By all appearances, AJS's main purpose is rather like that of a Democratic-leaning 527. Just as the 527s collect soft money from traditionally pro-Democratic interests and spend it to help defeat Republicans, AJS collects soft money from traditionally pro-Republican interests and spends it to defeat Democrats--but without facing any of the scrutiny the 527s do. Indeed, that's the whole idea. The Democratic shadow party has received massive press coverage during the past year, their donors demonized as shady fat cats by Bush surrogates in the conservative press.

Contributors can give to the Republican

501(c)s, however, with no fear of being outed. Dubke allows that his donors include corporations, other trade associations, and individuals, but won't disclose their names (though a few, including the American Insurance Association and the American Forest and Paper Association, have gone public with their involvement). It makes sense that corporations and trade groups that give to AJS might not want their names to get out. With business on Capitol Hill, and hence a need to court Democratic members of Congress, they don't necessarily want to be seen

contributing to a group that might be targeting some of those same Democrats. As Dubke puts it, "We have the ability to say things that other people might be afraid to say because they have other agendas and other interests."

Another GOP soft-money conduit is Progress for America, a self-described "national grassroots organization" that listed zero income from membership dues on its last tax return. Like many such groups, it is run by a handful of operatives with a half-degree of separation from the GOP. Its founder is Tony Feather, the political director of President Bush's 2000 campaign. Feather's own consulting firm handles direct-mail and get-out-the-vote contracts for Bush's reelection effort, the Republican National Committee, and the party's congressional campaign committees. The former political director of one of those committees, Chris LaCivita, is now executive director of PFA. The group's Web site used to describe its purpose as "supporting Pres. George Walker Bush's agenda for America," but that slogan, apparently too brazen to pass legal muster, has since been changed; now PFA supports "a conservative issue agenda that will benefit all Americans." The group hopes to raise up to \$60 million in soft money this year, and has enlisted the help of some prominent Republicans to do so, including Bush's campaign manager, chief campaign counsel, and party chairman. Thus, when Bush's lawyers accuse the Democrats of organizing a "soft-money conspiracy," they know what they're talking about.

Other GOP soft-money front groups include the American Taxpayer Alliance, run by Republican operative Scott Reed, and two groups chaired by former RNC lawyer Christopher Hellmich, Americans for Responsible Government and the National Committee for a Responsible Senate. Then there's the benignly-named United Seniors Association (USA), which serves as a soft-money slush fund for a single GOP-friendly industry: pharmaceuticals. USA claims a nationwide network of more than one million activists, but, just like Progress for America, listed zero income from membership dues in its most recent available tax return. USA does, however, have plenty of money on its hands. During the 2002 elections, with an "unrestricted educational grant" from the drug industry burning a hole in its pocket, the group spent roughly \$14 million--the lion's share of its budget--on ads defending Republican members of Congress for their votes on a Medicare prescription-drug bill.

So how much will these groups spend on behalf of the GOP this year? There's no way to know now, because, unlike 527s, these 501(c)s won't have to disclose their 2004 fundraising activities until 2005 at the earliest. But it's a pretty fair guess that they'll give their Democratic doppelgänger a run for its (soft) money. According to an investigation by *The Washington Monthly*, just three of the pro-GOP groups--Americans for Job Security, the United Seniors Association, and the American Taxpayer Alliance--spent close to \$40 million during 2002. And that was an off-year election. By contrast, the eight Democratic groups currently being sued by Bush's reelection campaign have raised about \$50 million so far during the 2004 presidential cycle.

### **Primary colors**

To the average person, it might seem that if the Democratic 527s are a cynical



mechanism for evading the ban on soft money, then surely the GOP-leaning 501(c)s are even more so. How, then, does the Republican shadow party get away with it? First, while the 527s admit that their ads are meant to affect elections, the 501(c)s do not. Instead, they insist that they're running "issue ads" intended merely to rouse debate about specific issues, not get anyone elected or defeated. Legally, this is considered "grassroots lobbying," an activity on which 501(c)s can spend unlimited amounts of money.

Now, the IRS code wisely allows 501(c)s to spend some of their money on ads meant to affect elections. Otherwise, traditional membership groups like the NAACP or Concerned Women for America wouldn't be allowed to make their voices heard on a candidate's position on, say, voting rights or gay marriage. So the second legal test is whether a group's "primary purpose" is to affect elections. The Democratic 527s admit up front that electioneering is their primary purpose; indeed, that fact is built into the legal definition of a 527. But to merit 501(c) status, the GOP groups must--and do--insist that electioneering is not their primary purpose. Indeed, like most of the GOP shadow groups, AJS reports on its 2000 returns spending zero dollars on political activity.

This is a curious claim for a group like AJS to make, considering it spends 95 percent of its budget on campaign-season ads that mention candidates. Indeed, were you to compare almost any Democratic 527 spot to one run by the Republican 501(c), you would be hard pressed to explain why one is intended to influence an election and the other is not. Following the 2000 elections, University of Wisconsin political scientist Kenneth Goldstein surveyed the issue-ad campaigns run by dozens of outside groups. As part of the study, his student volunteers viewed a series of AJS spots and answered the question, "In your opinion, is the purpose of the ad to provide information about or urge action on a bill or issue, or is it to generate support or opposition for a particular candidate?" They found without exception that what they had seen fell into the second category. When I mentioned the study to Mike Dubke, he responded, "I think that's ridiculous."

So who should decide whether AJS's ads are electioneering (and, hence, whether AJS's primary purpose is or is not political)? Legally, it's up to the Internal Revenue Service. But here, the GOP has yet another advantage. Because when it comes to checking up on nonprofits, the IRS makes the notoriously lax FEC look like a band of jackbooted thugs. Given that there are 1.4 million tax-exempt organizations in the United States, and enough personnel to inspect about 2,000 of them per year, the chance of a random audit is about one in 700. In practice, the IRS rarely investigates a nonprofit unless somebody files a complaint. And even then, privacy concerns constrain the IRS from revealing whether or not it has opened an investigation, and indeed whether or not it has come to any judgment.

But even if the taxmen did decide to take a closer look at AJS, it would still be in little danger of an unfavorable ruling. Since the IRS was never intended to police elections, the rules governing political activity by nonprofits are extraordinarily vague. In fact, there is no bright-line test for deciding whether an activity is political in nature or whether a 501(c) organization is "primarily" engaged in electioneering activities, and thus in violation of its tax status. Instead, IRS auditors judge organizations' activities on more than a dozen criteria and decide whether or not all

the "facts and circumstances" of those activities taken together "tend to show" a violation. In other words, the process is completely subjective.

Not surprisingly, this subjectivity makes the auditing process vulnerable to political pressure. And since taking control of Congress in 1995, the GOP has done its best to frighten the IRS away from snooping around. In 1998, Senate Republicans, hoping to galvanize the anti-tax vote for the upcoming elections, staged an elaborate series of hearings featuring horror stories of abusive behavior by IRS agents. A review by the General Accounting Office would later conclude that "no evidence was found of systematic abuses by agents." But by then Congress had passed legislation that hamstrung the agency's enforcement efforts. "IRS audit activity fell off dramatically across the board" after the hearings, notes Marcus Owens, a former director of the IRS's Exempt Organizations Division. "While it has recovered somewhat for individuals and corporations, it has not recovered for tax-exempt organizations."

When the IRS does try to step up to the plate, the agency usually gets smacked down. During the late-1990s, the IRS decided to revoke the tax exemption of a charity run by former Republican congressman Newt Gingrich, after finding that Gingrich had used it as a slush fund for his political action committee. But later, under pressure from a GOP member of Congress, the IRS reopened the case and restored the group's tax exemption.

### **Cop out**

It may not be surprising that, with President Bush in the White House and Congress run by his fellow Republicans, the IRS isn't going after the GOP's shadow party. A greater mystery is why the press and campaign finance groups haven't blown the whistle, even as they pound away at the Democrats' 527s. One reason is that--as with most things--the GOP "won the early game to define the issue," observes Simon Rosenberg of the New Democratic Network, a 527 which runs electioneering ads. "They convinced reporters that this was only about 527s." Another reason is that reformers in Washington are often like the drunk who looks for his keys not where he thinks he dropped them, but under a streetlamp, where the light is better. Because 527s must disclose their donors and expenditures every quarter, it's easier for political reporters and watchdog groups to blow the whistle on them in real time, issuing reports and press releases about the latest soft-money outrage. The 501(c)s disclose virtually nothing--and by the screwy rules of Washington, no data, no foul. "When it comes to 501(c)s, the information is so sparse that hardly anyone has ventured into this area," says Craig Holman of Public Citizen, one of the few groups that tries to keep tabs on 501(c) political activity.

Holman suggests that a first step towards minimizing this abuse is to require 501(c)s to be at least as transparent as 527s: They should disclose their donors and electioneering expenses quarterly, and the IRS should make that information available on the Web. This disclosure solution probably makes more sense than what the FEC seemed to be contemplating in April: Banning all 501(c)s from using any soft money for any political purpose, a move that might have, for example, made it impossible for nonprofits to run non-partisan voter registration drives. Not surprisingly, the FEC has backed off that idea and now seems inclined to take no

action against either 501(c)s or 527s, at least until after Election Day. That's good news for the Kerry campaign, though the GOP's campaign of harassment may well have scared off some liberal donors. But it's great news for the Bush campaign, since it means that groups like AJS can continue to work their magic under the radar with far less oversight than Democratic 527s.

Should the Republican shadow party give Bush the extra artillery he needs to prevail against Kerry, the newspaper editorialists and good-government activists may someday regret the fact that they decried the Democratic shadow party while blithely ignoring the Republican version. Not because it may help get Bush reelected (what do they care?) but because it will drive the whole soft-money political economy deeper underground. Should Kerry lose, the Democratic operatives running 527s may conclude that there's little value in declaring themselves openly as electioneering outfits. Instead, they'll likely transmogrify their groups into 501(c)s. Nobody will be able to see how much money George Soros gave this quarter, or figure out who sponsored that \$500,000 ad campaign in the St. Louis suburbs. Soft money won't disappear. It will just become invisible.

*Additional reporting for this article was provided by Jason Stevenson and Kathryn Williams.*

Nicholas Confessore is an editor of *The Washington Monthly*.

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